

MARKET BASED SOURCING

Market Based Sourcing

- A method of calculating corporate tax for multi-state corps.
- Collects less tax from NC Companies
- Collects more tax from out of state companies
- Collects less tax from out of state companies that choose to become NC Companies
- Provides an economic incentive with small impact to General Fund Revenue

Market Based Sourcing Corporate Tax Impact on Multistate Service Company

A state cannot tax all of a multistate company's income (Fed. Law). But a state can set the policy that determines what percentage of income it will tax.

Existing NC law for a service company

- % of income taxed = % of employees and investment in the State
- An increase in NC employment and investment = increase in tax bill

Market Based Sourcing

- % of income taxed = % of revenue received from NC market (NC customers)

NC already uses market based sourcing for companies that sell goods.

NC Lab Inc. Income = \$200 million

50% employees/investment in NC, 10% of services are for NC customers

Current Law

NC Income Tax = \$2.5 Million

(\$200 million x 50% x 2.5% tax rate)

If company puts more of its jobs in NC and starts doing 75% of work at NC facility, then:

NC Income Tax = \$3.75 million

\$200 million x 75% x 2.5% tax rate

Expand in NC = more tax in NC

Market Based Sourcing

NC Income Tax = \$500,000

(\$200 million x 10% x 2.5% tax rate)

If company puts more of its jobs in NC and starts doing 75% of work at NC facility, then:

NC Income Tax = \$500,000

\$200 million x 10% x 2.5% tax rate

Expand in NC does not = more tax

Market Based Sourcing

General Fund Impact

- Provides an economic incentive with small impact to General Fund Revenue.
- Corp. A that uses NC more as a place for jobs/investment has less income subject to tax.
- Corp B that has customers in NC but uses NC less as a place for jobs/investment has more income subject to tax.
- Corp A and Corp B have offsetting effect that neutralizes impact of market based sourcing on General Fund Revenue, while providing an incentive for both corporations to expand or relocate operations to NC.

HOW TO TREAT INCOME FROM INTANGIBLES?

Income from licensing the rights to use intangibles.

- Intangible income = licensing the rights to use copyrights, patents, trademark
- Most states with market sourcing tax license fees based on where the rights are used to generate income.

Example

- Trademark Inc. licenses valuable trademark to national clothes retailer based in Connecticut.
- Retailer uses trademark on clothes offered and sold in multiple states
- A portion of Trademark's income is taxed in the states where its trademark is used to offer and sell the retailer's clothes

Income from licensing the rights to use intangibles.

- Broadcasting Rights = licensing the rights to offer a broadcast
- Most states with market sourcing also tax license fees received from broadcast rights based on where they are used to generate income. This is called audience factor.

Example

- Broadcast Network licenses the rights to Connecticut Cable Company to show ESPN broadcast of ACC basketball and other stuff to customers
- Cable Company offers Duke/Carolina broadcast to NC viewing audience
- Portion of Broadcast Network income would be taxed in NC where broadcast is shown

Options for Calculating NC income tax for Broadcast Networks Disney, CBS, NBC, Fox, etc.

- Current Practice: Income is not taxed in NC because of letter from the State
- Industry preferred method: Licensing Income would not be taxed in NC because Cable Company is not headquartered in NC
- Audience Factor Method: Part of Broadcast Network's income is taxed in NC because the Network benefits from the games and other programming being shown in NC. Most states with Market Based Sourcing use this method. Broadcast network benefits from this method in states like CA, NY, and GA.
- MPAA is also discussing other options with members for potential consideration.

Nowhere Income

- “Nowhere income” is income earned by a multi-state company that avoids being taxed by any state. It is not taxed here, there, or anywhere.
- Nowhere income can be created by a service company when it successfully lobbies for market based sourcing in its home state, while arguing against market based sourcing in away states.
- Nowhere income can be created by a broadcast network when it successfully lobbies for audience factor in its home state, while arguing against audience factor in away states.